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APPENDIX A

IN THE SUPREME COURT OF THE
STATE OF NEW MEXICO

No. 12,876

TAXATION AND REVENUE DEPARTMENT OF THE STATE OF NEW MEXICO, Petitioner,

vs.

F. W. WOOLWORTH COMPANY, a New York corporation, Respondent.

ORIGINAL PROCEEDING ON CERTIORARI

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OPINION

EASLEY, Chief Justice

Woolworth appealed to the Court of Appeals a decision of the New Mexico Taxation and Revenue Department (Department) which assessed additional corporate income taxes for fiscal year 1976-77. The Court of Appeals reversed the Department. We reverse the Court of Appeals.

There are three issues: (1) whether "gross up", meaning the foreign income taxes paid by Woolworth's foreign subsidiaries which Woolworth is required to report as dividend income in its federal income tax return in order

to claim a tax credit for those foreign taxes paid, is legitimately a part of the tax base upon which New Mexico income taxes are to be calculated; (2) whether the cash dividends Woolworth receives from its foreign subsidiaries are "business income" and therefore assessable for New Mexico income tax purposes; and (3) whether the facts and law here warrant a modification of the apportionment formula.

Woolworth, a New York corporation engaged in selling general merchandise at retail throughout the United States, has four subsidiary foreign corporations which are relevant here. Its German, Canadian and Mexican subsidiaries are wholly owned by Woolworth; and Woolworth owns 52.7% of its English subsidiary.

One legal writer has depicted the tangle of competing principles involved in these issues as a "lofty plateau of complexity." We agree. The first move to finding a way out of this maze is to isolate the first issue on gross-up from the other two, which the Court of Appeals failed to do.

I. Gross-up.

The literal meaning of the term "gross-up" has been lost in the labyrinth. However, it is used here to refer to the option an American multinational corporation has under the federal income tax law to claim credit for income taxes paid to foreign governments by its foreign subsidiaries. I.R.C. §§ 901-908. It results in a federal tax benefit to the corporation based on an adjustment made to federal taxable income. It must be recognized, however, that the New Mexico tax laws do not specifically confer the same benefit to the taxpayer.

The election with which we are concerned is that foreign taxes paid by a domestic corporation may be either deducted by the taxpayer (I.R.C. § 164(a)(3)) or credited against the tax due to the federal government (I.R.C. §§ 78

and 901-908). "In making these elections, the taxpayer has, presumably, lessened its federal income tax liability." *Caterpillar Tractor Co. v. Lenckos*, 77 Ill.App.3d 90, 395 N.E.2d 1167, 1176 (1979). As stated in *F. W. Woolworth Co. v. Commissioner of Taxes of State*, 133 Vt. 93, 328 A.2d 402, 404 (1974):

> The purpose of "gross-up" is to avoid giving the domestic corporation both a credit and a deduction for the foreign tax deemed paid on its federal income tax return, which would otherwise result from the allowance of a full credit against tax liability computed only on the dividend paid.

We deem it unnecessary to delve into all the intricacies of the federal laws and regulations. Suffice it to say that, since Woolworth decided to use the gross-up option, the income taxes paid by Woolworth's foreign subsidiaries to foreign governments must be deemed to be received as dividends and the amount must be added into gross income and be reflected in the slot on the tax return form from which federal income taxes are calculated. Treas. Reg. § 1.78-1 (1979).

Woolworth does not and cannot quarrel with the soundness of the inclusion of gross-up in the gross income figure on its federal income tax return which, at Woolworth's own deliberate and knowing option, contains a fictional amount representing dividends "deemed to have been received." Gross-up amounts to over $25,000,000 in this case, on which the Department is claiming unpaid taxes on the amount of income apportioned to New Mexico.

Thus, the important starting point is the figure of gross income. This necessarily includes gross-up, which must also be calculated in determining the amount placed on line 30 for "Taxable Income" on Federal Income Tax form No. 1120, filed by Woolworth for the 1976-77 tax year and on which federal taxes were payable.

The next step is to interrelate these federal statutes and rules with the New Mexico law. Section 7-2-2(S), N.M.S.A. 1978 establishes a "piggy-back" method of determining state taxable income by reference to federal law. It provides:

> "[B]ase income" [on which state taxes are calculated] means that part of the taxpayer's income generally defined as federal taxable income and upon which the federal income tax is calculated;

The New Mexico tax return form calls for the insertion of federal taxable income as the starting point for calculating state taxable income. "This is done for the convenience of the taxpayer, as a savings to the State, and to provide the State with a means of verifying the accuracy and honesty of a taxpayer's return." *Getty Oil Co. v. Taxation & Revenue Dept.*, 93 N.M. 589, 592, 603 P.2d 328, 331 (Ct. App. 1979).

It is clear that the taxable income figure entered on line 30 of form 1120, which must reflect the addition of gross-up in gross income, is the only amount that may be used in calculating Woolworth's taxes due in New Mexico. Most states that have enacted income tax laws define taxable income in the identical manner.

Nevertheless, Woolworth in this case did not add gross-up into the New Mexico taxable income amount, upon which Woolworth paid taxes to the State of New Mexico. The Department claimed a deficiency in taxes paid. Woolworth appealed to the Court of Appeals, which erroneously sustained Woolworth's position.

Woolworth does not deny that the combined federal and state laws mandate that gross-up be reflected as state taxable income. But, it argues that the figure is artificial, that inclusion of the additional amount in apportionable income is inequitable, and that the tax administrator has the au-

thority to cure the inequity "pending a legislative amendment." (There seems to be a tacit admission in this phrase that legislative action is probably necessary.) Woolworth further states that the administrator's authority is contained in the statute which permits a modification of the apportionment formula. The company also urges that gross-up is not income because that term means acquisition of an economic benefit. A due process constitutional issue was raised on the theory that if gross-up is included in taxable income, Woolworth is entitled to deduct the amount of any taxes paid or deemed paid. The basis of the Court of Appeals' ruling was that gross-up is not dividend income and could not be classified as "business" income.

These issues have been answered against Woolworth's contentions in a number of cases. Admittedly, the fictitious gross-up, which the state claims is "business income" and which Woolworth deliberately acceeded to, does not fit the ordinary definition of "income":

> But a state has the power to gauge its income tax by reference to the income on which the taxpayer is required to pay a tax to the United States. The constitutionality of state statutes which refer to the Internal Revenue Code definitions have been upheld by the courts. See, *Garlin v. Murphy*, 51 Misc.2d 477, 273 N.Y.S.2d 374 (1966), aff'd 34 N.Y.2d 921, 359 N.Y.S.2d 552 (1974); *Thorpe v. Mahin*, 43 Ill.2d 36, 250 N.E.2d 633 (1969); 85 C.J.S. Taxation § 1096b; Annot., Constitutionality, construction, and application of provisions of state tax law for conformity with Federal income tax law or administrative and judicial interpretation, 166 A.L.R. 516 (1947), supplemented in 42 A.L.R.2d 797 (1955) and its supplement.

Champion International Corp. v. Bureau of Revenue, 88 N.M. 411, 416, 540 P.2d 1300, 1305 (Ct. App. 1975), *cert. denied*, 89 N.M. 5, 546 P.2d 70 (1975). In *F. W. Woolworth*

Company v. Commissioner of Taxes, 130 Vt. 544, 298 A.2d 839 (1972), the court held:

> Appellant contends that gross-up does not fit into the definition of "income" under the decisions of the United States Supreme Court that there must accrue, at the very least, some economic benefit or accession to wealth to the taxpayer before he can be said to have realized "income." There is no finding that by the election to use the gross-up rule the appellant did not realize an economic benefit. It clearly appears from the record, however, that the contrary is shown to be the fact. Woolworth's Vermont and federal income tax returns disclose that it gained a decided tax advantage dollarwise by exercising the option to use gross-up as a credit on its federal tax liability.
>
> Construing the provisions of the pertinent tax statutes, we conclude it was the clear intent of the legislature that appellant's tax base must include the gross-up.

298 A.2d at 844. There is no claim and no finding that Woolworth did not obtain an economic benefit from the gross-up procedure here.

In *Caterpillar, supra*, the court examined several of the same complaints made here and found that after making an election which presumably lessened the taxpayer's federal income tax liability, the taxpayer was trying to reverse the effect of that election. The court stated:

> Federal net income is certainly a reasonable starting point for determining corporate net income for Illinois income tax. (Citation omitted.) As a result of their own elections, the plaintiffs have not deducted the amount of foreign taxes from and have added certain hypothetical income to their gross income, and for federal income tax purposes, they are bound by those elections. Nothing in our existing Illinois law can be

> found to relieve the plaintiffs of the consequences of their choices for Illinois income tax purposes. (Citation omitted.) The granting of such a deduction is a privilege created as a matter of legislative grace, and no one is entitled to a deduction not clearly allowed by statute, the burden being on the taxpayer to demonstrate entitlement to the claimed deduction. (Citation omitted.)

395 N.E.2d at 1176-77.

The Illinois court held further that a court has no authority to create such a deduction. In our case the Court of Appeals effectively created a deduction that is not warranted by the statutes. *See Albany Intern. Corp. v. Helperin*, 388 A.2d 902 (Me. 1978); *see also Dow Chemical Co. v. Commissioner of Revenue*, 391 N.E.2d 253 (Mass. 1979).

Dow rejected the argument that Subpart F income was not income under the Sixteenth Amendment of the United States Constitution, citing *Estate of Whitlock v. C.I.R.*, 494 F.2d 1297 (10th Cir. 1974), *cert. denied*, 419 U.S. 839 (1974).

In *Getty Oil Co. v. Taxation and Revenue Department, supra* at 593, 603 P.2d at 332 (Ct. App. 1979), the court said: "It is our further opinion that the phrase 'federal taxable income and upon which the federal income tax is calculated' is unambiguous and self-explanatory." We agree.

We reverse the decision of the Court of Appeals which, in effect, would give Woolworth a deduction from the line 30 figure without statutory authority on the grounds that gross-up is not in fact dividend income and cannot be classified as "business income." We do not think the question involves a determination of whether the income is classified as "business income." Rather, we held that it involves consideration of a statute that is constitutional,

unambiguous and not subject to statutory construction. *See Hutchinson v. State*, 89 N.M. 501, 554 P.2d 663 (1976).

II. Stock Dividends From Foreign Subsidiaries as "Business Income"

In addition to deducting gross-up from its taxable income on the New Mexico income tax return, as discussed in the first point, Woolworth deducted the cash stock dividends paid to it by its subsidiaries. The Department restored this income, apportioned it as business income and made an additional assessment. Woolworth appealed the ruling to the Court of Appeals, which reversed the Department's ruling.

In examining the propriety of the Department's action, there are three basic questions: (1) whether dividends from Woolworth's foreign subsidiaries are "business income" under Section 7-4-2(A), N.M.S.A. 1978 and are thus properly apportioned and assessed by the Department, or whether the dividends are "nonbusiness income" and thus allocable only to the state in which Woolworth has its "commercial domicile"; (2) whether this state's allocation of the dividends from foreign subsidiaries violates Woolworth's right of due process, because of being taxation of income not earned in New Mexico; and (3) whether the Court of Appeals improperly shifted the burden of proof of certain factors relevant to these issues.

The Department cites the following evidence favorable to its position on these issues: Woolworth owns a majority or all of the stock in its subsidiaries, has the power of total control if it cares to exercise it, has an international vice president that is responsible for overseeing its foreign subsidiaries, has interlocking directors with some of the subsidiaries, includes the subsidiaries in its overall financing and planning and would be derelict in its obligations to its shareholders if it did not oversee the operations

of these companies. The managing directors of the subsidiaries are selected by Woolworth. The dividends paid are determined by Woolworth. There is a substantial exchange of business information, a teletype communication system and travel back and forth of executive personnel between the parent and its affiliates. Any substantial borrowing or other major decisions require approval of Woolworth. There is some flow back and forth of goods and financial resources. Management responsibilities are given to the foreign corporations only commensurate with the development of their abilities to act independently of the parent. In the past Woolworth has furnished investment capital and has made loans to its subsidiaries, but there were no debts outstanding at the time in question here. The dividends here were placed in Woolworth's general operating fund.

Woolworth introduced considerable evidence to support its contention that its foreign subsidiaries are independent of the parent and not part of a unitary enterprise and, therefore, the dividends received from them could not be constitutionally apportioned and assessed in New Mexico. We do not detail this evidence since we are considering the substantiality of evidence supporting the Department's decision, although all of the evidence has been assessed by the Court.

A. *Whether Stock Dividends of Woolworth's Foreign Subsidiaries Are Business Income.*

To overturn the Department's decision we must find that it is arbitrary, capricious or an abuse of discretion, not supported by substantial evidence or otherwise not in accordance with the law. § 7-1-25, N.M.S.A. 1978 (Repl. Pamp. 1979). Regrettably, it needs to be said that the State did a very poor job of inquiring into and developing the facts in this case.

Mr. William D. Dexter, General Counsel for the Multistate Tax Commission and the author of the amicus brief in this cause, has said:

> One of the most vexing problems facing the states and the business community in application of state income tax laws is the development of appropriate attribution rules for the taxation of income derived from intangible property interests by multistate-multinational corporations and their intertwined, affiliated and subsidiary corporations. (Footnote omitted.)

Dexter, *Taxation of Income from Intangibles of Multistate-Multinational Corporations*, 29 Vand.L.Rev. 401, 401 (1976).

A bit of history is appropriate to an understanding of the New Mexico statutory scheme for dealing with this problem. In recent years, the case law on the tests to determine apportionability within a given state of foreign or out-of-state income of multinational or multistate corporations has been developing along two parallel lines. Before the promulgation of the Uniform Division of Income for Tax Purposes Act (UDITPA), the "unitary business" concept was developed to meet the due process challenge. This principle calls for a determination as to whether a number of business operations having common ownership constitute a single or unitary business or several separate businesses for tax purposes and it depends upon whether they are of mutual benefit to one another and each operation is dependent on or contributory to others. *Great Lakes Pipe Line Co. v. Commissioner of Taxation*, 272 Minn. 403, 138 N.W.2d 612 (1965). The cases hold that, in order to meet due process constraints, there must be some minimal connection between the interstate business activities generating the income and the states seeking to tax that income. *See Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978).

The other line of cases looks at UDITPA and the rules passed in conjunction therewith and attempts to answer

the questions by a literal reading of the statutes and rules. UDITPA was promulgated by the Conference of Commissioners on Uniform State Laws in 1957 in response to the apportionment problem. 7A Uniform L. Ann. 91 (1978). New Mexico adopted the Uniform Act in 1965. 1965 N.M. Laws, ch. 203, codified in §§ 7-4-1 to 21, N.M.S.A. 1978. In 1967 the New Mexico Legislature enacted the Multistate Tax Compact. 1967 N.M. Laws, ch. 56, codified in §§ 7-5-1 to 7, N.M.S.A. 1978. The stated purposes of this legislation are to facilitate determination of the tax liability of multistate taxpayers, promote uniformity and convenience and avoid duplicative taxation. § 7-5-1, N.M.S.A. 1978. The Multistate Tax Commission in 1973 recommended regulations to be used in attributing corporate income among the states under UDITPA and these regulations were later adopted in New Mexico. N.M. Inc. Tax Regs.

The purpose here is to provide a system by which each state in which a multistate corporation does business can obtain its fair share of income taxes and no more. We read the statutes as calling for a method of allocation which is fairly calculated to assign to New Mexico that portion of the net income reasonably attributable to the business done in this state. *See Butler Bros. v. McColgan,* 315 U.S. 501 (1942).

Under UDITPA, all "business income" is apportioned to the state under a formula set forth in Section 7-4-10. Section 7-4-19 provides for equitable adjustment if the apportionment of taxable income does not fairly represent the extent of the taxpayer's business activity in the state. The figure resulting from the apportionment is then assessed for taxation by the state. "Nonbusiness income", is generally allocable to the "commercial domicile" of the taxpayer under the Act. § 7-4-5.

Thus the determination of whether the dividends received by Woolworth from its foreign subsidiaries are "business income" under UDITPA is crucial. The advan-

tage to Woolworth if it prevailed nationwide on its claim that gross-up and dividends from stock in foreign subsidiaries are deductible from gross income, as being nonbusiness income, is quite obvious, considering that this income would be apportionable only to the state of the corporation's commercial domicile, New York, where no income taxes are charged. Nationwide, Woolworth would get a tax windfall on $65,000,000 of income for this tax period.

UDITPA defines "business income" and "nonbusiness income" as follows:

> A. "business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations;
>
> . . . .
>
> D. "nonbusiness income" means all income other than business income;

§ 7-4-2, N.M.S.A. 1978.

N.M. Inc. Tax Regulation 17(a) expounds on the meaning of "business income":

> In essence, all income which arises from the conduct of trade or business operations of a taxpayer is business income.
>
> . . . .
>
> . . . [T]he critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions and activity which are the elements of a particular trade or business. In general, all transactions and activities of the taxpayer which are dependent upon or contribute to

> the operation of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activity arising in the regular course of, and constitute integral parts of, a trade or business.

N.M. Inc. Tax Regulation 17(b)(4) provides:

> Dividends are business income where the stock with respect to which the dividends are received arises out of or was acquired in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the stock is related to or incidental to such trade or business operations.

The Court of Appeals, in *Tipperary Corp. v. New Mexico Bur. of Rev.*, 93 N.M. 22, 595 P.2d 1212 (Ct. App. 1979), *cert. denied*, 92 N.M. 675, 593 P.2d 1078 (1979), analyzed Section 7-4-2(A), N.M.S.A. 1978, and divided the definition of business income into two parts: (1) transactions and activity in the regular course of a taxpayer's trade or business, and (2) situations where acquisition, management and disposition of property constitute integral parts of the taxpayer's regular trade or business operations, citing *McVean & Barlow, Inc. v. New Mexico Bureau of Rev.*, 88 N.M. 521, 543 P.2d 489 (Ct. App. 1975), *cert. denied*, 89 N.M. 6, 546 P.2d 71 (1975). The Court then decided *Tipperary* on the first part of the definition, ruling that the evidence showed that a sale of oil and gas leases was an activity in the regular course of Tipperary's business. Dexter, *supra*, 29 Vand.L.Rev. 401 (1976), calls the first prong a "transactional test" and the second prong a "functional or use test".

In *Tipperary*, the Court also adopted from Judge Wood's concurring opinion in *Champion, supra*, a three-prong test to determine whether income arises from transactions in the regular course of business: (1) the nature of the par-

ticular transaction, (2) former practices of the business entity, and (3) how the income is used. *See Qualls v. Montgomery Ward & Co. Inc.*, 266 Ark. 207, 585 S.W.2d 18 (1979); *Sperry and Hutchinson Co. v. Department of Revenue*, 270 Or. 329, 527 P.2d 729 (1974); *Great Lakes, supra.* We hold that there is substantial evidence here to meet all the tests required in *Tipperary.* The income arose from activities of Woolworth in the regular course of its business. The income was acquired and managed as an integral part of its regular business operations. § 7-4-2(A). The purpose for acquiring and holding the stock is related to its business operations. N.M. Ind. Tax Regulation 17(a). The three-prong *Tipperary* test of Judge Wood is fully met by the evidence in favor of apportionability.

B. *Constitutionality of Including the Dividends as Business Income.*

Having determined that the dividends are "business income" apportionable under the New Mexico statutes, we now must examine whether the State's assertion of apportionability is constitutional.

The United States Supreme Court, in the case of *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), decided after the Court of Appeals' decision in our case, has answered a number of our questions.

In *Mobil* the Commissioner of Taxes in Vermont ruled that dividend income from Mobil's foreign subsidiaries and affiliates should be included in the tax base. Mobil claimed that this action unconstitutionally subjected the corporation to multiple taxation. The Supreme Court of Vermont found a sufficient nexus between the corporation and the State of Vermont to justify an apportioned tax on the dividends. The United States Supreme Court affirmed the decision, holding that the tax does not violate the due process clause or the commerce clause and does not impose a burden on foreign commerce.

The Court in *Mobil* recognized some general principles:

> It long has been established that the income of a business operating in interstate commerce is not immune from fairly apportioned state taxation. (Citations omitted.) "[T]he entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S., at 460. For a State to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a "minimal connection" between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise. (Citations omitted.) The requisite "nexus" is supplied if the corporation avails itself of the "substantial privilege of carrying on business" within the State; and "[t]he fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction." *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444-445 (1940).

Id. at 436-37.

Mobil, however, contended that "its *dividend* income must be excepted from the general principle of apportionability because it lacks a satisfactory nexus" with Mobil's business activities in Vermont. *Id.* at 437. But the Court ruled that the foreign source of the income would not preclude its taxability so long as the intrastate and extra-state activities formed part of a single unitary business. *See also Exxon Corp. v. Wisconsin Dept. of Revenue*, —— U.S. ——, 100 S.Ct. 2109 (1980); *Butler Bros., supra.* The Court stated that separate accounting may fail to account for contributions to income resulting from functional integra-

tion, centralization of management, and economies of scale. These factors of profitability arise from the operation of the business as a whole and "it becomes misleading to characterize the income of the business as having a single identifiable 'source'." *Supra* at 438.

The Court further stated:

> [T]he linchpin of apportionability in the field of state income taxation is the unitary-business principle. In accord with this principle, what apellant must show, in order to establish that its dividend income is not subject to an apportioned tax in Vermont, is that the income was earned in the course of activities unrelated to the sale of petroleum products in that State. *Bass, Ratcliff & Gretton* [266 U.S. 171] forecloses the contention that the foreign source of the dividend income alone suffices for this purpose.
>
> . . . .
>
> Nor do we find particularly persuasive Mobil's attempt to identify a separate business in its holding company function. So long as dividends from subsidiaries and affiliates reflect profits derived from a *functionally integrated* enterprise, those dividends are income to the parent earned in a unitary business. One must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability.
>
> Superficially, *intercorporate division* might appear to be a more *attractive basis for limiting apportionability.* But the form of business organization may have nothing to do with the underlying unity or diversity of business enterprise. Had appellant chosen to operate its foreign subsidiaries as separate divisions of a legally as well as a functionally integrated enterprise, there is little doubt that the income derived from those divisions would meet due process requirements

> for apportionability. Cf. *General Motors Corp. v. Washington*, 377 U.S. 436, 441 (1964). Transforming the same income into dividends from legally separate entities works no change in the underlying economic realities of a unitary business, and accordingly it ought not to affect the apportionability of income the parent receives.
>
> . . . Where the business activities of the dividend payor have nothing to do with the activities of the recipient . . ., due process considerations might well preclude apportionability, because there would be no underlying unitary business. (Emphasis added and footnotes omitted.)

Id. at 439-42.

The Court was similarly unpersuaded by Mobil's contention that the Vermont tax imposes a burden on foreign commerce, reasoning that this argument attempted to focus attention on the effect of foreign taxation when the effect of domestic taxation is the real issue. The Court held that the only inquiry of constitutional dimension is "the familiar question whether taxation by apportionment at home produces significantly greater tax burdens than taxation by allocation." *Id.* at 447. The Court ruled that Mobil had failed to demonstrate any sound basis, under either the due process clause or the commerce clause, for establishing a constitutional preference for allocation of its foreign source income to the state of commercial domicile. *See Exxon, supra.* The Court distinguished *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), relied on by Woolworth here.

Thus, under *Mobil*, the key question in determining the constitutionality of the allocation of Woolworth's dividends from foreign subsidiaries as apportionable "business income", is whether those dividends were income earned in a unitary business.

Our Court of Appeals has previously addressed this issue in *Champion, supra,* where the income in question was from renting an unneeded portion of its office building, short-term investments of operating capital and profit from the sale of timber. Champion claimed that the income was not part of its multistate unitary business. The Court of Appeals held that the income was business income since it was obtained from normal and customary practices of the corporation, and stated:

> A multi-state business is a "unitary business" for income tax purposes when operations conducted in one state benefit and are in turn benefited by operations in another state. [Citing *Great Lakes, supra.*] "If its various parts are interdependent and of mutual benefit so as to form one integral business rather than several business entities, it is unitary." *Webb Resources, Inc. v. McCoy,* 194 Kan. 758, 766, 401 P.2d 879, 886 (1965).

Id. at 413, 540 P.2d at 1302.

Generally, "unitary business" means a business, "the component parts of which are too closely connected and necessary to each other to justify division or separate consideration as independent units." *Maxwell v. Kent-Coffey Manufacturing Co.,* 204 N.C. 365, 168 S.E. 397, 399 (1933), *aff'd without opinion,* 291 U.S. 642 (1934); *see Butler Bros., supra; Great Lakes, supra.*

Woolworth's investments in its foreign subsidiaries exceeded those of the parent corporation. The possession of large assets by subsidiaries is a business advantage of great value to the parent; "it may give credit which will result in more economical business methods; it may give a standing which shall facilitate purchases; it may enable the corporation to enlarge the field of its activities and in many ways give it business standing and prestige." *Flint v. Stone Tracy Co.,* 220 U.S. 107, 166 (1911); *see Montgomery*

Ward & Co. Inc. v. Commissioner of Taxation, 276 Minn. 479, 151 N.W.2d 294 (1967); *Great Lakes, supra.*

The Supreme Court of New Jersey has considered the precise question as here and concluded that Woolworth's is a unitary business and that its foreign dividends are business income. *F. W. Woolworth Co. v. Director of Div. of Taxation*, 45 N.J. 466, 213 A.2d 1 (1965).

On the due process issue and in conformity with *Mobil*, we hold that, for income tax considerations, there is substantial evidence in this record that Woolworth was conducting a unitary business with its foreign subsidiaries and that there is a sufficient nexus between the corporation and the State of New Mexico to justify an apportioned tax on these dividends. The income is obviously related to the mutual activities of the parent and its affiliates. The control over the subsidiaries, the interdependence, the history of the relationships, the placing of the money in the general operating account, all point to functional integration and reveal an underlying unitary business for our purposes here. We reverse the Court of Appeals on this point. *Mobil, supra; Am. Smelting & Refining v. Idaho St. Tax Com'n*, 99 Idaho 924, 592 P.2d 39 (1979).

Woolworth's claims as to violations of the commerce clause have no validity and are fully answered in *Mobil.*

C. *Burden of Proof.*

The Department complains that the Court of Appeals erroneously shifted the burden of proof to the Department on the question of what use was made of the income from foreign dividends. The *use* is pertinent in determining whether there is a unitary business. *See Tipperary, supra; Sperry and Hutchinson Co. v. Department of Revenue, supra.* The Department found that the dividends were placed in Woolworth's general fund and used for general corporate operating expenses. But the Court of Appeals

stated that, since there was no evidence to conclude that the money was *used* for general corporate operating expenses, it was more reasonable to conclude that the money simply passed through the general treasury to the stockholders by way of dividends.

The Court of Appeals erred in so concluding. First, the burden was on Woolworth to demonstrate the uses made of the dividends. *See Tipperary, supra; Champion, supra.* This rule is based on the theory that the burden on an external agency of ascertaining the internal financial practices and procedures of a business is nearly insurmountable. *See General Motors v. Washington,* 377 U.S. 436 (1964); 29 Am.Jur.2d, *Evidence,* § 131 (1967). Also, once it was established that the dividend income had been deposited in the general corporate operating fund and no evidence as to its use was introduced, the Department's reasonable inferences are conclusive. *See Waldroop v. O'Cheskey,* 85 N.M. 736, 516 P.2d 1119 (Ct. App. 1973).

III. Apportionment

Woolworth claims that it was not given the full benefit of the factors in the apportionment formula, that this results in unfairness, and that the Department has statutory authority to correct inequities. The Court of Appeals never reached the issue of modification of the apportionment formula because of its holding that gross-up and dividends should not be included in Woolworth's tax base. After the hearing in this case, the Department did modify the formula to the extent of adding the foreign dividends and the foreign dividend gross-up amounts to Woolworth's sales factor denominator. Woolworth claims that this adjustment was not enough, but offered no evidence upon

which further adjustments could be predicated. The Department found that Woolworth failed to present "a reasonable and specific proposal" for further adjustments to Woolworth's payroll, sales and property factors and denied further modification to the formula.

"One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed. (Citation omitted.)" *Butler Bros., supra* at 508. The taxpayer has the burden of establishing his exemption. *Norton Co. v. Dept. of Revenue,* 340 U.S. 534 (1951).

The burden of proving what modifications were necessary was definitely on Woolworth. *Donald M. Drake Company v. Department of Revenue,* 263 Or. 26, 500 P.2d 1041 (1972); *Deseret Pharm. Co., Inc. v. State Tax Comm.,* 579 P.2d 1322 (Utah 1978); *see* Dexter, *The Business Versus Nonbusiness Distinction Under the Uniform Division of Income for Tax Purposes Act,* 10 Urban Lawyer 243 (1978). Further, New Mexico courts have held and our statutes provide that any assessment of taxes is presumed to be correct. *Tipperary, supra; Champion, supra;* § 7-1-17, N.M. S.A. 1978 (Repl. Pamp. 1979).

There was nothing arbitrary or unreasonable about the Department's conclusion that dividend income is apportionable without modification of the formula. *See In Re Goodyear T. & R. Co., Corp. Income T., 1966, 1967, 1968,* 133 Vt. 132, 335 A.2d 310 (1975); *F. W. Woolworth Co. v. Commissioner of Taxes of State, supra.* Also, there being no substantial evidence upon which further adjustments may be predicated, we affirm the decision of the Department on this issue.

This case is reversed and judgment shall enter for the Department.

IT IS SO ORDERED.

/s/ MACK EASLEY
Mack Easley, Chief Justice

WE CONCUR:

/s/ DAN SOSA, JR.
Dan Sosa, Jr., Senior Justice

/s/ WILLIAM R. FEDERICI
William R. Federici, Justice

PAYNE, Justice

I must respectfully dissent and agree with the analysis of the Court of Appeals.

IN THE COURT OF APPEALS OF THE STATE OF NEW MEXICO

No. 3954

F. W. Woolworth Co., a New York corporation,
Appellant,

v.

Bureau of Revenue, State of New Mexico,
Appellee.

ADMINISTRATIVE APPEAL

[Filed, Court of Appeals of New Mexico, Dec. 4, 1979,
Hazel M. Davis, Clerk]

Michael D. Bray
New York, New York
John P. Dwyer
Albuquerque, New Mexico

Attorney for Appellant.

Jeff Bingaman, Attorney General
Sarah Bennett, Special Ass't Atty. General
Santa Fe, New Mexico

Attorney for Appellee.

OPINION

Walters, Judge

The Taxation and Revenue Department assessed additional corporate income taxes for taxpayer's fiscal 1976-77 year, and the taxpayer appeals. Woolworth contends that the Department's inclusion in Woolworth's base income of dividends paid to the parent company by foreign subsidiaries and foreign dividend "gross-up" amounts was unauthorized under New Mexico tax statutes. Those amounts, it says, do not constitute taxable business income under § 7-4-2A, N.M.S.A. 1978, and are not apportionable under

the Uniform Division of Income for Tax Purposes Act, "UDITPA" (§ 7-4-1 through 7-4-21, N.M.S.A. 1978).

The resolution of the appeal lies in determining whether either item, gross-up or foreign dividends, is business income. Only if both categories fit the description of "business income" may they be assessed for state tax purposes.

The statutory definition of business income was discussed in *Champion Int'l Corp. v. Bureau of Revenue*, 88 N.M. 411, 540 P.2d 1300 (Ct.App.), *cert. den.* 89 N.M. 5, 546 P.2d 70 (1975), and recently in *Tipperary Corp. v. New Mexico Bureau of Revenue*, 93 N.M. 22, 595 P.2d 1212 (Ct. App.), *cert. den.* 92 N.M. 675, 593 P.2d 1078 (1979). Section 7-4-2A requires a supportable finding, to classify income as "business income," that the income arose (1) from transactions and activity in the regular course of the taxpayer's trade or business, or (2) from situations where the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

In a special concurrence in *Champion, supra*, Chief Judge Wood said:

> Pertinent in determining whether income arises from transactions in the regular course of business is "the nature of the particular transaction" and "former practices" of the business entity. [Citation omitted] Also pertinent is how the income is used. [Citation omitted.]

Taxpayer is a corporation having its principal place of business in New York. It receives dividend income from four foreign subsidiaries. "Gross-up" is the term applied to foreign taxes paid by the foreign subsidiaries which under Internal Revenue Code § 78 taxpayer is "deemed" to receive, and is reportable as dividend income if the taxpayer elects to claim a foreign tax credit on its federal return as permitted by Internal Revenue Code § 902.

1. Inclusion of gross-up as New Mexico business income.

The State urges that taxpayer must include gross-up in its apportionable New Mexico base income because the state income tax forms prescribed by the Director of the Department of Revenue and Taxation instruct the taxpayer to report "Federal Taxable Income as shown on Federal Form 1120, Line 30 . . ." and because § 7-2-2(S) defines base income as "federal taxable income and upon which the federal income tax is calculated."

Line 30 of the federal tax return is not exclusively determinative of what is federal taxable income. *Getty Oil Company v. Taxation and Revenue Dept.*, No. 3723 (Ct.App.), filed October 18, 1979. The gross-up figure included as dividend income in the federal return is reported only because the foreign taxes paid from those "deemed" dividends are later allowed to be deducted as a credit in computing taxes payable to the federal government. If the foreign tax credit were not claimed, the gross-up would not be "deemed" income and would not be reportable.

The definition of § 7-2-2(S) contended for by the Department ignores the portion of subsection (S) referring to the amount "upon which the tax is calculated." The calculation of federal tax does not rest solely on the amount shown at Line 30 of Form 1120; it is *calculated* upon that figure *less* certain credits shown at lines 10(a), (b) and (c), and *plus* other amounts shown at lines 13, 14, 15, and 16, all in Schedule "J" of the federal return. The foreign tax credit, which is not reflected in Line 30, is one of the amounts affecting calculation of the federal income tax.

The rigid insistence of the Department which requires the taxpayer to use only the Line 30 figure in reporting New Mexico income is a refusal to recognize an obviously fictitious income figure, made artificial by the federal reporting requirements for a specific purpose, and denies the taxpayer the right to show the true federal taxable income

"no matter where . . . [it] might be found in its consolidated federal return." *Getty, supra.* "That which is not in fact the taxpayer's income cannot be made such by calling it income." *Hoeper v. Tax Commission of Wisconsin,* 284 U.S. 206, 215, 76 L.Ed. 248, 56 S.Ct. 120 (1931).

"Gross-up" in fact represents income to taxpayer's foreign subsidiaries which is paid out in taxes to foreign governments. The record does not support the decision of the Director of the Revenue Division that the foreign subsidiaries use "a part of the taxpayer's dividends to pay taxes on behalf of the parent." The taxes paid are from income of the subsidiaries on behalf of the subsidiaries. "Gross-up" is not in fact dividend income to the taxpayer; ergo, it cannot be classified as "business" income, and it need not be included in taxpayer's New Mexico tax return. Sections 7-4-2A, D; N.M.S.A. 1978. *See F. W. Woolworth Co. v. Comm'r of Taxes,* 133 Vt. 93, 328 A.2d 402, 407 (Larrow, J. dissenting).

2. Inclusion of dividends from foreign subsidiaries.

The department also determined that $39,881,161 received by taxpayer in actual cash dividends from its foreign subsidiaries and excluded by the taxpayer from apportionable income subject to New Mexico tax, were derived from "an integral part of the corporation's operations." As such, they were assessed as business income, and a portion of the total amount was allocated as New Mexico's apportionable share for taxpayer's New Mexico operations.

Woolworth contends that its domestic operations constitute a unitary business of which the foreign subsidiaries are no part, and to which the foreign activities contribute nothing in the production of domestic income. Paragraphs 6 through 15 of the Department's Decision and Order support taxpayer's argument that unity of business operation among the domestic parent and the foreign subsidiaries is missing. The Department agrees that taxpayer operates a

unitary business in the United States, phrasing the argument on the question of foreign dividends as taxable business income in this fashion:

> The issue is whether the dividend income of a concededly unitary domestic corporation from substantial investment in its foreign subsidiaries is business income to be apportioned along with all other business income of the unitary business.

The Department relies in part on Paragraph 16 of the Director's decision which recites that the dividends are "placed in the general funds of the taxpayer and used for general corporate operating expenses." This reliance goes, of course, to the pertinency of use in determining whether such income was business income. *See Champion*, 88 N.M. at 418; *Tipperary, supra*, 595 P.2d at 1218. The evidence does support a finding that the dividends were deposited to taxpayer's general treasury; there is no evidence that the money was used for "general corporate operating expenses." As appellant taxpayer points out, the total cash dividends under discussion amounted to $39,881,161. During the same tax year, Woolworth paid out $39,986,308 in dividends to its United States shareholders. It is more reasonable to regard the dividend income as merely passing through the general treasury to stockholders than to declare, without any evidence in support, that it is used for operating expenses of the corporation.

Turning to the "regular course of business" analysis set out by Judge Wood in the *Champion* special concurrence, we note that the taxpayer's initial and only investment in the English subsidiary was $64,000 in 1911. When the German facilities were demolished during World War II, taxpayer contributed $400,000 to its rebuilding. The Mexican and Candian corporations are wholly owned subsidiaries. None of them are presently in debt to the parent company, and all of the subsidiaries have grown on their

own reinvestments. The dividend income from the foreign corporations is declared by the taxpayer as income to the parent allocable only to the state of domicile, New York, since the taxpayer contends that it is non-business income. Sections 7-4-2A, D, N.M.S.A. 1978.

The facts here are close to those of *Sperry & Hutchinson Co. v. Department of Revenue*, 527 P.2d 729 (Or. 1974). Like Woolworth, Sperry & Hutchinson (S & H) did business in forty-eight states and was domiciled in New York. Its primary and only business in Oregon was sale of a trading stamp promotional service to retailers. From its revenues, S & H invested in short-term securities held to satisfy its need for liquid capital in the stamp business; short-term securities held pending acquisition of other companies or favorable development in the long-term money market, and long-term securities held as an investment. The Oregon Supreme Court ruled, under a statute virtually identical to § 7-4-2A, N.M.S.A. 1978, that only the short-term investments which provided capital needed to meet business obligations during periods of cash flow deficits constituted "business income 'arising from transactions and activity in the regular course of the taxpayer's trade or business' . . . ." (527 P.2d at 731.)

The other investments, it said, were "not apportionable to Oregon because neither the capital invested nor the income derived therefrom are a part of the . . . business conducted in this state," and there was no showing that the interest on those investments was held for use in its Oregon business. That is also the state of the record presently before this court. There is no indication that the income from Woolworth's long-standing investments was used either in taxpayer's unitary domestic business or in its business conducted in New Mexico, *Champion, supra* (Wood, C.J.); *Sperry & Hutchinson v. Bureau of Revenue, supra.* Nor was there evidence (1) that the investments were "[b]usiness deals [or] the performance of a specific

function in the normal, typical, customary or accustomed policy or procedure of the taxpayer's trade or business," *Champion, supra* (Sutin, J.); (2) that the interest arose "from transactions in the regular course of [taxpayer's] business," *Champion, supra* (Wood, C.J.); (3) that there was any "relationship of the income source to the [regular] business activities of the taxpayer," *Tipperary, supra* (Lopez, J.); or (4) that investing in foreign corporations was "an integral part of the regular trade or business operations of taxpayer," *McVean & Barlow, Inc. v. New Mexico Bureau of Revenue,* 88 N.M. 521, 524, 543 P.2d 489 (Ct.App. 1975).

Accordingly, we reverse the decision and order of the Department insofar as it includes those gross-up and dividend income amounts in taxpayer's 1976-77 taxable income.

IT IS SO ORDERED.

/s/ MARY C. WALTERS
Judge

WE CONCUR:

s/ Joe W. Wood, C. J.

s/ B. C. Hernandez, J.

BEFORE THE DIRECTOR OF THE REVENUE DIVISION OF THE TAXATION AND REVENUE DEPARTMENT OF THE STATE OF NEW MEXICO

In the Matter of the Liability of
F. W. Woolworth Company, I.D. No. 002154,
Under Assessment No. 224952.

Decision and Order

This matter came on for a hearing before John E. Owens on October 4, 1978 and was continued for the purpose of submitting briefs. F. W. Woolworth Company was represented by Michael Bray, Esq. The Taxation and Revenue Department ("Department") was represented by Richard M. Kopel, Esq.

On the basis of all the evidence presented, it is decided and ordered that:

1. This is a corporate income tax matter. F. W. Woolworth Company (herein called "taxpayer" or "parent") is a corporation with its headquarters in New York City. In its federal income tax return the taxpayer showed (a) a total amount of dividends from foreign corporations and (b) an amount for "foreign dividend gross-up". These two items totaled over 65 million dollars. On its New Mexico income tax return the taxpayer treated this total as non-business income and allocated the income to New York, the taxpayer's commercial domicile. The then Bureau of Revenue concluded that this amount should be treated as business income to be apportioned as provided in the Income Tax Act.

Gross-up and Withheld Taxes

2. When a United States parent corporation receives dividends from a foreign subsidiary corporation and the re-

cipient chooses the benefits of the foreign tax credit provided by the Internal Revenue Code, the recipient is "deemed" to have paid a portion of the foreign income tax paid by the foreign corporation that relates to the foreign source dividends. Income Tax Regulations § 1.902.1. The taxes "deemed" to be paid by the United States parent shall be treated as a dividend received by the United States parent. I.T. Reg. § 1.78-1. Thus, the deemed to be paid foreign tax is treated as dividends received and added to the United States parent's gross income. This is called gross-up.

3. It has been specifically held that "gross-up" is income for state income tax purposes. *F. W. Woolworth Company v. Commissioner of Taxes,* 298 A.2d 839 (Vt. 1972); *F. W. Woolworth Company v. Commissioner of Taxes,* 328 A.2d 402 (Vt. 1974). And other state courts have held that where a state tax statute defines income to mean federal tax income, taxable income for federal purposes is taxable income for state tax purposes. *Champion International Corporation v. Bureau of Revenue,* 88 N.M. 411 (1975); *Commonwealth of Pennsylvania v. Westinghouse Electric Corporation,* 386 A.2d 491 (1978), *app. dism.* —— U.S. ——, (Docket No. 78-138, October, 1978). Because under the Internal Revenue Code the "gross-up" amounts are treated as dividends received by the taxpayer and becomes part of the taxpayer's federal taxable income, the gross-up amounts must be included in the taxpayer's "base income" as defined in § 72-15A-2(S). See *Champion International Corporation v. Bureau of Revenue, supra.*

4. Part of the "dividends" shown in the taxpayer's federal return consisted of foreign withholding taxes. These relate to dividend payments made by the foreign subsidiaries. Foreign subsidiaries are often required to withhold foreign taxes on dividends paid. These taxes are withheld and paid by the foreign subsidiaries to foreign governments to satisfy the tax obligations of the parent. In this

role, the foreign subsidiary is using part of the taxpayer's dividends to pay taxes on behalf of the parent. These withheld foreign taxes are considered as dividend income to the parent and these withheld foreign taxes are included in the taxpayer's federal taxable income. The foreign withholding taxes must be treated as income for New Mexico income tax purposes.

Deductions

5. There is no provision in the New Mexico Income Tax Act which would permit this taxpayer to deduct any of these items of income in arriving at its New Mexico base income. In *Commonwealth of Pennsylvania v. Westinghouse Electric Corporation, supra*, the Court interpreted a statute similar to the New Mexico Income Tax Act and concluded that where a taxpayer has voluntarily elected to utilize the federal tax credit route, the taxpayer cannot tax a deduction for state tax purposes. The federal rule is the same. If a taxpayer claims the foreign tax credit, no portion of the foreign taxes may be taken as a deduction. I.T. Reg. § 1.901-1(c). For New Mexico income tax purposes the taxpayer is not entitled to deduct items of income which are not deductible for federal tax purposes.

Business or Non-business Income

6. The taxpayer is engaged throughout the United States in the business of selling general merchandise at retail. It purchases inventory items and sells them to the public through Woolworth and Woolco retail stores. The Woolworth stores sell a variety of consumer items including dry goods, hardware, small appliances, candy and some packaged food and some clothing items. Most, if not all, also serve fountain items and meals. Woolco stores are considered to be discount stores; they retail a broader range of items than do the Woolworth stores.

7. Over the years the taxpayer has acquired or established subsidiaries in the United States and in foreign countries. In particular, there are four foreign subsidiaries with which we are concerned.[1]

A. F. W. Woolworth Company, Ltd., is an English corporation, 52.7 percent of which is owned by the taxpayer. The balance of the stock is owned by the public. Its chief executive—called managing director—is an citizen of England and has held this position for a number of years. It sells, at retail, through 2,000 Woolworth and Woolco stores throughout the British Isles.

B. F. W. Woolworth, Gmbh, is German corporation, wholly owned by the taxpayer. It has two managing directors, both of whom are German nationals. It sells items at retail through Woolworth stores.

C. F. W. Woolworth, Ltd., is a Canadian corporation, wholly owned by the taxpayer. It's president is a Canadian. This subsidiary sells retail items through Woolworth and Woolco stores.

D. F. W. Woolworth, S.A. de C. V. Mexico, is a Mexican corporation, wholly owned by the taxpayer, and it operates in Mexico selling through 12 Woolworth stores.

8. Each of the four subsidiaries are responsible for determining the size and location of retail stores, the market conditions in their own territory and the mix of items to be sold. The German subsidiary emphasizes soft goods such as dresses and coats. It sells no food. The English subsidiary operates restaurants in its stores and also operates supermarkets. Each subsidiary attempts to cater to local tastes and needs. The inventory of each subsidiary consists, in large part, of home country produced items. This purchase-

[1] There are foreign subsidiaries and sub-subsidiaries owned by the taxpayer other than the four subsidiaries with which we are concerned.

at-home practice is consistent with the policy of the taxpayer. A number of inventory items are purchased from the Orient or other places but there is no evidence that the subsidiaries purchase, or are required to purchase, inventory items from any particular source.

9. The English and German companies handle their own advertising (there is very little advertising in Germany), and their own local accounting; each have policies on employees; and each have local outside counsel.

10. The taxpayer does not have a personnel training school for the foreign subsidiaries. In the taxable year involved, none of the four subsidiaries officers were currently or formerly employees of the parent. An officer in a Spain subsidiary and an officer of the Mexico subsidiary were also participants in the taxpayer's profit sharing plan and the taxpayer paid the employee's share of such plan.

11. The taxpayer has a large board of directors, approximately 15 persons. The managing director of the English subsidiary is on the taxpayer's board and the English subsidiary. The parent company sends an officer to participate in the English board of directors meetings. At least one person who is on the Canadian subsidiary is also on the taxpayer's board. At least one officer of the Canadian subsidiary is also an officer of the taxpayer.

12. Chief executives of the subsidiaries who are not on the taxpayer's board, are not in regular attendance at the taxpayer's board meetings. Such executives, or subordinate officials attend board meetings when the taxpayer wants them present. The taxpayer has no department or section, as such, devoted to overseeing the foreign subsidiary operations. The taxpayer's chief executive and other officers of the taxpayer visit the foreign subsidiary operations and vice versa. The taxpayer has a vice president who is the liaison man with the smaller foreign subsidiaries. There is frequent communication between the parent and the subsidiaries by mail, telephone or teletype.

13. The parent has the right to control the financial matters of the subsidiaries. Individual subsidiaries are responsible for the day-to-day financial matters but major decisions must be approved by the parent. The taxpayer determines the amount of dividends to be paid by the subsidiaries.

14. The parent's financial statements—e.g., annual report—are prepared on a consolidated basis which includes the parent and all wholly owned subsidiaries. The English subsidiary is not included in the consolidated statements.

15. The English subsidiary was established a number of years ago. The taxpayer paid $64,000 for its interest in the subsidiary. The parent may have loaned money to the subsidiary but if so, there is no outstanding debt. The German corporation facilities were, in effect, demolished during World War II and the subsidiary was revived after the War. The parent loaned or made a capital contribution of about $400,000 to this subsidiary after the war.

16. The four subsidiaries declared and paid dividends to the parent. Dividends received by the taxpayer from the four subsidiaries were placed in the general funds of the taxpayer and used for general corporate operating purposes.

17. This taxpayer was previously involved in similar state tax questions. In *F. W. Woolworth Company v. Director of Division of Taxation*, 213 A.2d 1 (1965), the New Jersey Supreme Court held that this taxpayer and its Canadian, Mexican, German and English subsidiaries were engaged in a unitary operation. *F. W. Woolworth v. Commissioner*, 298 A.2d 839, the Vermont Supreme Court in holding that "gross-up" dividends are subject to apportionment was holding *sub silento*, that the taxpayer and its subsidiaries were engaged in a unitary operation.

18. The evidence in this case shows that the foreign subsidiaries operated in a similar, if not an identical, fashion as did the parent: sales of similar products; use of the Woolworth and Woolco names; interlocking directors; com-

munication of business matters which concern both parent and subsidiary. In addition, the parent had fiscal and management control over the subsidiaries. Considering all the evidence, it is concluded that the income in question is business income, subject to apportionment.

Modifications to the Statutory Formula

19. The taxpayer alternatively claims that in this case there must be modifications to the three factor formula provided in UDITPA (§ 72-16A-34); specifically the taxpayer wants the foreign corporations' payroll, sales and property added to the denominator of the taxpayer's payroll, sales and property factor.

20. At least two states have considered the provisions of UDITPA and concluded that the three factor apportionment formula should be applied uniformly, and it is only in exceptional situations may the relief provisions in UDITPA be applied. *Donald M. Drake Company v. Department of Revenue*, 500 P.2d 1041 (1972); *Deseret Pharmaceutical Company, Inc. v. State Tax Commission*, 579 P.2d 1322 (Utah, 1978). And the party who seeks to deviate from the statutory formula and invoke the applicability of the relief provisions has the burden of proof. *Deseret Pharmaceutical Company, supra.*

The Department has added the "dividends" and the "foreign dividend gross-up" amounts to the taxpayer's sales factor denominator.[2] Increasing the taxpayer's denominator does result in a smaller sales factor. The taxpayer says this adjustment is not enough; but the taxpayer has not shown specifically what adjustments to the taxpayer's payroll, sales and property factor are proper and necessary to come up with an equitable result as envisioned in § 72-15A-34.

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[2] Actually the so-called sales factor spoken of in § 72-16A-31 is in reality a gross receipts factor. "Sales" is defined in § 72-15A-17 as all gross receipts not allocated.

21. Taxpayer argues that the Department must use the three factors of the foreign subsidiaries but it fails to suggest that the Department might then also take into account the net income of the foreign subsidiaries. In fact, however, the Department is not attempting to impose a tax on the net income of the foreign subsidiaries; the New Mexico tax is on the business income of the taxpayer and the taxpayer fails to show how the foreign subsidiaries' factors relate to this taxpayer's business income.[3]

22. In its brief, the taxpayer "petitions" for a modification of the statutory three factor formula. Assuming *arguendo* that this petition is timely, the taxpayer has not presented a reasonable and specific proposal which would meet the requirements of § 72-15A-34.

23. The taxpayer's protest is denied.

Done this 2nd day of January, 1979, in Santa Fe, New Mexico.

ARTHUR B. SNEAD
Director, Revenue Division

By /s/ JOHN E. OWENS
John E. Owens
Hearing Examiner
Taxation and Revenue Department

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[3] Although some courts have expressed views similar to those proposed by the taxpayer (e.g., see the *Woolworth* cases in New Jersey and Vermont, cited *supra*) it is doubtful that looking at the payroll, sales and property of one corporation (a foreign subsidiary) is appropriate in attempting to apportion income of a different corporation (the domestic parent). Short of taxing a parent on a "combined" basis, there seems to be no authority, under § 72-15A-34, to look beyond the payroll, property and sales of the particular taxpayer. This taxpayer has never suggested filing a report on a combined basis.

Certificate of Mailing

I hereby certify that a true copy of this Decision and Order was mailed to F. W. Woolworth Company, Executive Office, Woolworth Building, New York, New York 10007 and to Michael D. Bray, Esq., Armstrong & Bray, 20 Exchange Place, New York, New York 10005 all on this the 2nd day of January, 1979.

/s/ JOHN E. OWENS
John E. Owens

APPENDIX B

IN THE SUPREME COURT OF THE
STATE OF NEW MEXICO

Friday, January 30, 1981

No. 12,876

TAXATION AND REVENUE DEPARTMENT OF THE STATE OF NEW MEXICO, Petitioner,

vs.

F. W. WOOLWORTH COMPANY, a New York corporation, Respondent.

Original Proceeding on Certiorari

This matter having heretofore been submitted and taken under advisement, and an opinion of the Court having been handed down on January 19, 1981 and Judgment entered reversing the decision of the Court of Appeals, and no motion for rehearing having been filed;

NOW, THEREFORE, IT IS ORDERED that the Judgment entered herein on January 19, 1981, reversing the decision of the Court of Appeals be and the same is hereby made final, and the cause be and the same is hereby remanded with directions that Judgment be entered for the Department.

IT IS FURTHER ORDERED that the Record in Cause No. 3954 be and the same is hereby returned to the Clerk of the Court of Appeals.

ATTEST: A TRUE COPY

/s/ ROSE MARIE ANDRETE
Clerk of the Supreme Court of the State of New Mexico

IN THE COURT OF APPEALS OF THE
STATE OF NEW MEXICO

Administrative Appeal No. ——

No. 3954

F. W. Woolworth Co., Appellant

v.

Bureau of Revenue, Appellee

Mandate

(Applicable items are indicated by an "X" below.)

1. — Attached is a true and correct copy of the original decision entered in the above-entitled cause.

2. — This decision being now final, the cause is remanded to you for any further proceedings consistent with said decision.

3. X Writ of Certiorari having been issued by the New Mexico Supreme Court and their decision now being final, this cause is remanded to you for any further proceedings consistent with said Supreme Court decision attached hereto.

4. — You are directed to issue any commitment necessary for the execution of your judgment and sentence.

5. — Cost Bill is assessed as follows:

6. — District Court Clerk's Record returned herewith.

7. — Exhibits filed herein shall be picked up at this Clerk's Office forthwith.

By direction of and in the name of the Chief Judge of the Court of Appeals, this 6th day of February, 1981.

(SEAL)
CC: Counsel

/s/ SUSAN W. BAGWELL
Clerk of the Court of Appeals of
the State of New Mexico.

(Tear off and return this receipt)

No. 3954

RECEIPT IS ACKNOWLEDGED of the original mandate and Clerk's Record.

DATED: _____ _____
Clerk of the District Court

[ATTEST: A true copy. Susan W. Bagwell, Clerk of the Court of Appeals of the State of New Mexico.

By: /s/ VERA C. LOPEZ, Deputy]

APPENDIX C

IN THE SUPREME COURT OF THE STATE OF NEW MEXICO

No. 12,876

TAXATION AND REVENUE DEPARTMENT OF THE STATE OF NEW MEXICO, Petitioner-Appellee,

vs.

F. W. WOOLWORTH Co., a New York Corporation, Respondent-Appellant.

Notice of Appeal
To the Supreme Court of the United States

[Court of Appeals of New Mexico, FILED, March 20, 1981, Susan W. Bagwell]

Notice is hereby given that F. W. WOOLWORTH COMPANY, the appellant above-named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of New Mexico, entered in this proceeding on January 19, 1981, reversing the judgment of the Court of Appeals.

This appeal is taken pursuant to 28 U.S.C. 1257(2).

Dated: This 26th day of March, 1981.

/s/ JOHN P. DWYER

John P. Dwyer, Attorney for
Respondent-Appellant
1210 Bank of New Mexico Building
Albuquerque, New Mexico 87102
(505) 247 9586

APPENDIX D

New Mexico Statutes 1978, Annotated

7-2-2. Definitions.

* * * * * * * * * *

S. "base income" means that part of the taxpayer's income generally defined as federal taxable income and upon which the federal income tax is calculated;

T. "net income" means base income adjusted to exclude:

(1) amounts that have been taxed as income to another member of an affiliated group of corporations under the Banking and Financial Corporations Tax Act [7-6-1 to 7-6-9 NMSA 1978]; and

(2) amounts that the state is prohibited from taxing because of the laws or constitution of this state or the United States; and

* * * * * * * * * *

7-4-2. Definitions.

* * * * * * * * * *

A. "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations;

* * * * * * * * * *

7-4-3. Allocation and apportionment of income in general.

Any taxpayer having income which is taxable both within and without this state, other than the rendering of purely personal services by an individual, and making the election to do so as provided in the Income Tax Act [7-2-1 to 7-2-22

N.M.S.A. 1978], shall allocate and apportion his net income as provided in the Uniform Division of Income for Tax Purposes Act [7-4-1 to 7-4-21 N.M.S.A. 1978].

7-4-5. Allocation of certain nonbusiness income.

Rents and royalties from real or tangible personal property, capital gains, interest, dividends, or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in Sections 6 through 9 [7-4-6 to 7-4-9 N.M.S.A. 1978] of the Uniform Division of Income for Tax Purposes Act.

7-4-8. Allocation of interest and dividends.

Interest and dividends are allocable to this state if the taxpayer's commercial domicile is in this state.

7-4-10. Apportionment of business income.

All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

7-4-11. Property factor for apportionment of business income.

The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.

APPENDIX E

Internal Revenue Code

SEC. 78. DIVIDENDS RECEIVED FROM CERTAIN FOREIGN CORPORATIONS BY DOMESTIC CORPORATIONS CHOOSING FOREIGN TAX CREDIT.

If a domestic corporation chooses to have the benefits of subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year, an amount equal to the taxes deemed to be paid by such corporation under section 902(a) (relating to credit for corporate stockholder in foreign corporation) or under section 960(a)(1) (relating to taxes paid by foreign corporation) for such taxable year shall be treated for purposes of this title (other than section 245) as a dividend received by such domestic corporation from the foreign corporation.

SEC. 902. CREDIT FOR CORPORATE STOCKHOLDER IN FOREIGN CORPORATION.

[Sec. 902(a)]

(a) TREATMENT OF TAXES PAID BY FOREIGN CORPORATION—For purposes of this subpart, a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends (determined without regard to section 78) bears to the amount of such accumulated profits in excess of such income, war profits, and excess profits taxes (other than those deemed paid).

APPENDIX F

1981 Opinion No. 15

IN THE SUPREME COURT OF THE STATE OF IDAHO

No. 12198

Boise term, January 1981

Filed: March 4, 1981

R. H. Young, Clerk

AMERICAN SMELTING & REFINING Co., Plaintiff-respondent,

v.

IDAHO STATE TAX COMMISSION, Defendant-appellant.

On remand from the United States Supreme Court.

Prior opinion and order of this Court are *reinstated.*

David Leroy, Attorney General; Theodore V. Spangler, Jr., Deputy Attorney General, for State Tax Commission, Boise, Idaho, for appellant.

Philip E. Peterson, Lewiston, Idaho, and George Beatty, of Lee, Toomey & Kent, Washington, D.C., for respondent American Smelting & Refining Co.

William D. Dexter, Olympia, Washington, for amicus curiae Multistate Tax Commission.

Tyrone Fahner, Attorney General of Illinois, Chicago, Illinois, for amicus curiae State of Illinois.

PER CURIAM:

The order of this Court in American Smelting & Refining Co. v. Idaho State Tax Commission, 99 Idaho 924, 592 P.2d

39 (1979), was vacated by the United States Supreme Court in ASARCO, Inc. v. Idaho State Tax Commission, 445 U.S. ——, 100 S.Ct. 1333 (1980), and remanded for further consideration in light of the decision of the United States Supreme Court in Mobil Oil Corp. v. Comm'r of Taxes of Vermont, 445 U.S. ——, 100 S.Ct. 1223 (1980). The case having been rebriefed and reargued, it is the conclusion of this Court that our prior opinion and order are consistent with both *Mobil Oil* and the more recent decision in Exxon Corp. v. Wisconsin Dept. of Revenue, 445 U.S. ——, 100 S.Ct. 2109 (1980). The opinion and order in American Smelting & Refining Co. v. Idaho State Tax Commission, 99 Idaho 924, 592 P.2d 39 (1979), are hereby reinstated.

APPENDIX G

Statutory Treatment of "Section 78 Gross-up" in the 33 States Which Have Adopted the Federal Income Base

States	Gross-up Not Excluded Under Cols. 2, 3 or 4	Excludes § 78 Gross-up	Excludes All Dividend Income	Partial Exclusion of Dividend Income
Arizona		X*		
Colorado		X		
Connecticut		X		
Delaware		X		
Florida		X		
Georgia			X	
Hawaii		X		
Idaho	X			
Illinois		X		
Indiana	X			
Iowa	X			
Kansas	X			
Kentucky			X	
Maine		X		
Maryland		X		
Michigan		X		
Massachusetts			X	
Missouri	X			
Montana	X			
Nebraska	X			
New Jersey		X		
New Mexico	X			
New York		X		
North Carolina				X**
North Dakota	X			
Ohio		X		
Oklahoma	X			
Pennsylvania			X	
Rhode Island	X			
Tennessee				X
Vermont		X		
Virginia		X		
West Virginia			X	

* This result is reached by allowing a deduction for foreign tax credits, including "deemed paid" credits, unless all dividends from the subsidiary are deducted under other provisions.